

Feature

Regulation

Three way split

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Many firms are failing to meet the FSA's guidance on TCF and depriving themselves of commercial benefits because they do not see its true value

With the Financial Services Authority (FSA) due to issue a paper specifically addressing treating customers fairly (TCF) in the mortgage market, mortgage intermediaries cannot afford to neglect their TCF initiatives. And yet many remain unsure about what action they should take.

However, focussing on 'fair process' should be at the core of every organisation's approach. Fair processes can ensure that customers feel genuinely fairly treated – the critical factor in maximising commercial benefits from TCF initiatives. By using fair management processes, firms can also secure employee commitment to the initiative and thus effect the genuine cultural change advocated by the FSA.

Unfortunately, many firms still appear to be taking a 'box-ticking' approach. In so doing, they are not only disregarding the FSA's guidance but also depriving themselves of the considerable commercial benefits of a TCF strategy that delivers real improvements from a customer perspective.

A logical first step to developing a more holistic TCF approach is to establish what it is that customers believe to be fair. In this context, it is interesting to note that the Financial Ombudsman Service (FOS) found that around 80% of complainants were satisfied by how it had treated them, even though it upheld only around 30% of complaints.

Considering that a complaint only reaches the Ombudsman after a customer has complained about the service from a provider and then complained again about the way their grievance was addressed, these figures seem surprising. What they demonstrate, however, is that outcome is not the overriding factor determining consumer perception of fairness.

The Ombudsman attributes the statistics to the way it handles complaints, continually informing complainants about the status of their case. So it seems that process can be at least as important as outcome in delivering what customers are likely to view as fair.

Favourable outcomes

This tallies with the findings of social scientists John W. Thibaut and Laurens Walker, who in the mid-1970s produced the first academic research to show that, in the context of the legal system, people care as much about the fairness of the process as the outcome it produces. There is ample evidence across financial services – and almost every other economic sector – to suggest that, when the process is perceived to be fair, most people will accept outcomes that are not wholly in their favour.

Most mortgage lenders have a good idea of the outcomes likely to give rise to customer dissatisfaction. There may always, for example, be complaints from borrowers who have not fully understood the redemption penalties on fixed rate products. However, knowing which processes customers may perceive as unfair is far more complex. So often it is unanticipated consequences and glitches in processes, of which management may be completely unaware, that cause the greatest upsets.

Of course the people likely to have the best understanding of how customers react to processes are the staff who are responsible for implementing them with customers. Engaging front-line staff to think about how processes affect customers and how fair their impact is should therefore be a core component of any firm's TCF strategy.

Involving staff in this way has a dual benefit. Clearly, it can be an effective way of honing processes to protect customers. However, it is also a highly successful means of achieving genuine cultural change that places the customers' interests at the heart of the organisation's strategy and operations, as the FSA requires.

Here too the concept of fair process has an important role to play. Just as customers will readily accept outcomes they do not really like if they believe those outcomes are the result of a fair process, so staff will willingly become engaged in changes to their ways of working if they have faith in the underlying management process.

Fair process

In the early 1990s academics W Chan Kim and Renee Maubourgne discovered the managerial relevance of fair process. They showed that individuals are most likely to co-operate freely with management implementing new initiatives when fair process is observed.

Conversely, unfair processes, such as excessive management secrecy or imposing changes without taking employees' views on board, lead to workforce obstinacy and unease. Indeed, if the approach taken by management is perceived as unfair, even changes that employees might otherwise favour can be difficult to achieve.

For employees, participation in a fair process may lead them to go beyond the call of duty, sharing their knowledge and applying their creativity in pursuit of organisational goals. In customers, it can build loyalty driven by much more than economic self-interest, not only reducing the chances of complaints to external bodies but even potentially reducing price pressure. Moreover, research shows that loyal customers spend more on average and cost less to service so revenues and profits improve as a result.

In a management context, fair process has three critical components. The first is engagement. This means involving individuals in the decisions that affect them by asking for their input. The second is explanation, meaning that everyone involved and affected should understand why final decisions are made. The third is expectation clarity, which requires that once a decision is made, managers state clearly the new rules of the game so that employees know by what standards they will be judged and who is responsible for what.

In the non-academic, real world experience of financial services businesses, fair process can be observed in action in the management approach used at

companies such as the Royal Bank of Scotland. Part of the approach used in these organisations is a technique called 'work-out', originally pioneered by Jack Welch at GE. This technique offers a simple and highly practical solution for organisations seeking to set fair process as the heart of their TCF initiatives.

Work-out events are structured problem identification and problem solving meetings that can involve a cross-section of the organisation, from frontline staff to senior management and everyone in between. They are discussions where members of staff can acquire 'ownership' of problems and, by their involvement in the discussion, find and become part of the solutions. They provide the ideal forums for employees to describe for management how customers may be adversely or unfairly affected by existing processes and the consequences of this situation, and to suggest how those processes could be changed.

Senior management do not relinquish control because the 'work-out' participants must present their proposed solutions for approval at the end of the session. However, the senior decision-makers are obliged to make a clear decision about whether to implement the proposed solutions or not.

One major UK bank that employed 'work-out' as part of its post-merger integration, found it generated financial savings in excess of \$100m (£56.3m) across the group and released hundreds of thousands of man-hours of capacity. It also created a discernible change in employee attitudes. The results showed service improvements and behavioural shifts consistent with an increasingly empowered high performance organisation. This effectiveness in driving behavioural change makes it a similarly appropriate mechanism for re-focussing organisational culture around TCF.

A number of major financial services providers have seen the potential of TCF to deliver commercial gains by building consumer trust, improving customer relationships and enhancing the reputation of both individual firms and the industry as a whole. Some organisations have for that reason been swift to position themselves at the forefront of TCF, most notably Lloyds, HBOS and Barclays. The question now is to what extent these large players will dictate the standards expected of the rest of the industry.

For smaller players, with less economic clout, the risk is that they are unable to compete by using greater resources for aggressive pricing and marketing initiatives and simultaneously lose out in the TCF stakes. Under these circumstances, the adoption of a strategy that places the emphasis on the fairness of process rather than outcome – and in so doing secures customer loyalty – could be the only viable, and indeed a highly effective, way to respond.

Key points

Research has found that people care as much about the fairness of a process as its outcome.

Engaging staff to think about how processes affect customers should be a core component of any firm's TCF strategy.

Unfair processes, such as management secrecy, can result in workforce obstinacy and unease.

Source: Mortgage Solutions